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In the Supreme Court of the United States

OCTOBER TERM, 1958

WILLIAM LLOYD BARNARD, JOHN W. DAILEY, CHARLES W. HUMPHREY, DONALD HENRY SMALLIGAN, PETER JOHN SMEDES AND ROY HENRY STOUT, PETITIONERS

v.

UNITED STATES OF AMERICA

JOHN W. DAILEY, ROBERT E. LUKENS AND JAMES F. BOGUE, PETITIONERS

v.

UNITED STATES OF AMERICA

WILLIAM LLOYD BARNARD, WALTER H. MORSE AND HOMER A. KELLEY, PETITIONERS

v.

UNITED STATES OF AMERICA

DONALD HENRY SMALLIGAN, PETER JOHN SMEDES AND WILLIAM LLOYD BARNARD, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINION BELOW

The opinion of the court of appeals (Pet. 1A–12A) is not yet reported. The trial court sustained motions

to dismiss the indictments without opinion (R. 100–101, 113–114, 125–126, 130–131).[1]

JURISDICTION

The judgment of the court of appeals (SR. 20) was entered May 2, 1958. Petition for rehearing was denied on May 23, 1958 (SR. 26). On June 16, 1958, the time to file a petition for certiorari was extended to July 22, 1958. The petition for a writ of certiorari was filed July 21, 1958. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED

1. Whether the statute prohibiting kickbacks by subcontractors under Government "cost reimbursable" contracts (41 U. S. C. 51–54) is applicable to a contract providing that the price will be "negotiated" after performance is completed.

2. Whether knowledge of the terms of the prime contract is an essential element of the crime of paying kickbacks for the award of subcontracts under Government "cost reimbursable" prime contracts.

STATUTES INVOLVED

The "Anti-Kickback Act," 60 Stat. 37, 41 U. S. C. 51–54, provides in part as follows:

> SEC. 1. The payment of any fee, commission, or compensation of any kind or the granting of any gift or gratuity of any kind, either directly or indirectly, by or on behalf of a subcontractor, as hereinafter defined, (1) to any officer,

[1] References to the printed record filed in the court below are prefaced by "R." References to the certified record of supplementary proceedings are prefaced by "SR.".

partner, employee, or agent of a prime contractor holding a contract entered into by any department, agency, or establishment of the United States for the furnishing of supplies, materials, equipment or services of any kind whatsoever, on a cost-plus-a-fixed-fee or other cost reimbursable basis; or to any such prime contractor or (2) to any officer, partner, employee, or agent of a higher tier subcontractor holding a subcontract under the prime contract, or to any such subcontractor either as an inducement for the award of a subcontract or order from the prime contractor or any subcontractor, or as an acknowledgment of a subcontract or order previously awarded, is hereby prohibited. * * * The amount of any such fee, cost, or expense shall be recoverable on behalf of the United States from the subcontractor or the recipient thereof by set-off * * * or by an action in an appropriate court of the United States. Upon a showing that a subcontractor paid fees, commissions, or compensation or granted gifts or gratuities to an officer, partner, employee, or agent of a prime contractor or of another higher tier subcontractor, in connection with the award of a subcontract or order thereunder, it shall be conclusively presumed that the cost of such expense was included in the price of the subcontract or order and ultimately borne by the United States. * * *

* * * * *

SEC. 4. Any person who shall knowingly, directly or indirectly, make or receive any such prohibited payment shall be fined not more than $10,000 or be imprisoned for not more than two years, or both.

Section 371 of Title 18, U. S. Code, as amended, provides in part as follows:

> If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

* * * * *

STATEMENT

The ten petitioners were indicted in four indictments for violations of the so-called Anti-Kickback Act, 41 U. S. C. 51–54, and for conspiracies to violate that statute (R. 1, 105, 117, 129). The indictments were dismissed upon motions by the petitioners (R. 100–101, 113–114, 125–126, 130–131). The court of appeals reversed and remanded the case to the district court with directions to deny the motions to dismiss (Pet. 1A–12A).

At all times here involved, the General Motors Corporation was the prime contractor under a contract with the Air Force for the production of F–84F jet aircraft (R. 9). Two of the petitioners were head tool buyers for General Motors, in which capacity they administered subcontracts and purchase orders awarded under the prime contract (R. 2, 106, 118, 129). The remaining petitioners were owners, officers, partners or sales managers of manufacturing companies which obtained these subcontracts (R. 2, 3, 106, 118, 129). The indictments charged the General

Motors employees with accepting, and the other petitioners with giving, gratuities as an inducement or acknowledgment for aid and assistance in obtaining purchase orders and subcontracts under the Air Force contract (R. 3, 105, 118–119, 129–130). The alleged kickbacks were either based upon a commission of 5 percent (R. 4, 119), amounting to partial payments as high as $3,004.20 (R. 4, 6, 119, 130), or took another guise, such as a gift of a clothes washer and a drier (R. 5, 6), a personal loan (R. 107), or monthly payments on a car (R. 107).

The General Motors prime contract was described in the indictments as a "fixed price reimbursable contract with a price redetermination clause" (R. 2, 106, 118). By agreement of the parties, the contract itself was introduced into the record (R. 9–94) and considered in ruling on the motions to dismiss. It provides in part as follows:

> (a) The Contractor shall furnish to the Government the articles and supplies in the quantities and at the unit and total prices set forth below, which prices are subject to the Clause of the General Provisions entitled "Revision of Prices": [R. 11]
>
> * * * * *
>
> 41. REVISION OF PRICES (RETROACTIVE FOR FIRST PERIOD).—(a) The prices in Part I may be increased or decreased in accordance with this Clause.
>
> (b) *Times for negotiation.*—Upon acceptance of the 71st airplane to be furnished under this contract, the parties shall negotiate to re-

vise the prices of all items theretofore and thereafter to be delivered. * * *

(c) *Submission of data.*—At the time * * * specified * * * the Contractor shall submit (i) a new estimate and breakdown of the unit cost and the proposed prices of the items remaining under this contract * * *; (ii) an explanation of the differences between the original * * * estimate and the new estimate; (iii) such relevant shop and engineering data, cost records, overhead absorption reports and accounting statements as may be of assistance in determining the accuracy and reliability of the new estimate; (iv) a statement of experienced costs of production hereunder to the extent that they are available at the time or times of the negotiation of the revision of prices hereunder; and (v) any other relevant data usually furnished in the case of negotiation of prices under a new contract. The Government may make such examination of the Contractor's accounts, records and books as the Contracting Officer may require and may make such audit thereof as the Contracting Officer may deem necessary.

(d) *Negotiations.*—(1) Upon the filing of the statements and data required by paragraph (c) of this Clause, the Contractor and the Contracting Officer will negotiate promptly in good faith to agree upon prices for items to be delivered on and after the effective date of the price revision. Negotiations for price revisions under this Clause shall be conducted on the same basis, employing the same types of data (including, without limitations, comparative prices, comparative costs, and trends

thereof) as in the negotiation of prices under a new Department of the Air Force contract. [R. 31–33]

On October 13, 1954, after completion of the first 71 airplanes, the parties executed a supplemental agreement substantially increasing the prices both of the 71 airplanes already delivered and of those yet to be delivered (R. 69). The indictments allege no events occurring after the date of that agreement (R. 1, 105, 117, 129).

Petitioners moved to dismiss the indictments on the grounds, among others, that the General Motors contract was not a "cost reimbursable" contract within the meaning of the Anti-Kickback Act and that the indictments did not allege that the petitioners knew the terms of the contract (R. 94–99, 108–113, 121–125). The district court dismissed the indictments without opinion (R. 100, 113, 125, 130). The court of appeals unanimously reversed, holding that the contract was on a "cost reimbursable basis" and that knowledge of the nature of the contract was not an essential element of the crime (Pet. 1A–12A).

ARGUMENT

Quite apart from the merits of the petitioner's contentions, the judgment is not final and there is no occasion to review it at this stage of the proceedings. The court of appeals remanded the case to the district court with directions to deny the motions to dismiss the indictments. There has been no trial and the petitioners have not yet been found guilty of any crime. Consequently this Court is now asked to de-

cide questions presented without benefit of any substantive testimony to clarify and develop the issues. The premature nature of the petition is emphasized by the fact that, had the motions to dismiss been denied by the district court in the first instance rather than on remand, the order would not have been appealable. *Catlin v. United States*, 324 U. S. 229, 236. For this reason alone the petition for certiorari should be denied. It will be time enough to consider whether the underlying issues merit further review after the facts have been fully developed at the trial—if, of course, the petitioners are convicted.

The decision of the court of appeals is, moreover, correct and is based on a reasonable interpretation and application of the statute. It is not in conflict with any other decision, and in the absence of such a conflict the questions presented are not of sufficient importance to require review by this Court.

1. The Anti-Kickback Act, 41 U. S. C. 51–54, is an attempt to outlaw "commercial bribery" in Government contracting. It forbids the giving of gratuities to holders of Government prime contracts, or their agents, to induce the award of subcontracts. By its terms, however, the statute applies only if the prime contract is on a "cost-plus-a-fixed-fee or other cost reimbursable basis." The primary question in this case is whether the prime contract involved falls within that category.

The proper characterization of the polar types of contracts is clear. On the one hand, the typical "cost-plus-a-fixed-fee" contract, in which the Government is expressly obligated to reimburse the contractor for

costs incurred by him, is clearly within the scope of the statute. On the other hand, the typical "fixed price" contract, in which the contractor obligates himself to perform the contract at a firm price established in advance and not affected by variations in actual cost, is equally clearly not within the statute. The difficulty arises where, as here, the contract does not fit either of these classic patterns but partakes in part of the character of each.

The instant contract neither fixes a price in advance (except as a nominal "target") nor specifically prescribes the way in which the final price is to be computed. Rather, as to the 71 airplanes involved here,[2] the contract provides simply that, after the performance has been completed and the actual costs of performance are known, the contractor and the contracting officer will "negotiate" a fair price. The question is whether, in the aspects relevant to the purposes of the Anti-Kickback Act, such a method of post-performance negotiation of prices is "more like" typical cost contracting or firm fixed-price contracting. That, in turn, depends on the reason for the distinction made by the act.

The Act itself amply discloses the reason for limiting its application to "cost reimbursable basis" contracts. In addition to the criminal penalties, the Act establishes, as a foundation for civil recovery of kickbacks, a conclusive presumption that the amount of any kickback "was included in the price of the subcontract or order and ultimately borne by the United States" (§ 1, *supra*, p. 3). In substance,

[2] See note 4, *infra*.

that is a graphic statement of the purpose of the Act: its primary concern is to protect the Government, as a contracting party, from the burden of prices inflated by kickbacks. In this light, the limitation to "cost reimbursable basis" contracts becomes readily understandable. Under such contracts the prices paid to subcontractors become costs to be reimbursed by the Government; if the subcontract price is inflated the cost to the Government is increased. Under a firm fixed-price contract, on the other hand, the contractor's actual costs are of no concern to the Government. The price—fixed by the competiton for the initial award of the contract—remains the same whether or not the contractor's experienced costs are increased because of kickbacks by subcontractors to his purchasing agents.

The proper test, therefore, of whether a prime contract should be deemed to be on a "cost reimbursable basis" for purposes of the Act is clear: would an increase in the contractor's subcontracting costs (a presumed result of kickbacks) probably be passed on to the Government? The prime contract involved in this case seems clearly to meet that test.

The "Revision of Prices" clause of the contract requires the contractor, after the first 71 planes have

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The important question, of course, is whether hidden kickbacks would be passed on. In the rare case where the kickback is discovered, the subcontract cost would presumably be partially disallowed even under a straight cost-plus-a-fixed-fee contract—for example, by treating the kickback as a reduction of the nominal price of the subcontract. It is the difficulty of discovering kickbacks in order to eliminate them from the costs that makes the imposition of criminal penalties necessary.

been delivered, to submit complete information on the cost of producing those items. The parties are then required to "negotiate" in "good faith" to "revise the prices" for those items.[4] The negotiations are to be conducted "on the same basis, employing the same types of data (including, without limitations, comparative prices, comparative costs, and trends thereof) as in the negotiation of prices under a new" contract (R. 33).[5] In addition to these standard provisions, the clause contains special provisions providing that certain specific items, the status of which might otherwise be questioned, "shall be recognized as being properly included in costs" (R. 34) or "shall be an allowable item of cost" (R. 35).

The contract thus imposes no objective standard for the determination of the price other than that necessarily implied by the duty to negotiate in "good faith"—that is, a fair and reasonable price. Clearly, in the absence of some extraordinary circumstance such as gross waste, that means that the contractor would normally be allowed to recover his costs plus a reasonable profit. What other general standard there might be to guide the negotiations in the usual case

[4] The parties are required at the same time to negotiate revised prices for the items yet to be delivered, but since all the alleged acts occurred during the production of the first 71 planes—*i. e.*, the retroactive-pricing phase of the contract—the method of pricing the subsequent deliveries is not in issue.

[5] Although not expressly so limited, this provision seems meaningful primarily in terms of the *prospective* pricing of the undelivered planes. See note 4, *supra*. It is not included in the standard clauses providing for a single price revision after completion of the entire contract. Compare Form II–B (¶ (d) (1)) with Form IV (¶ (c)) in 32 C. F. R. § 596.150–5 (1958 Supp.).

is not readily apparent. That such was the contemplation of the parties here, moreover, is directly evidenced by the special provisions providing for the allowability of certain items of cost that might otherwise have been matters of dispute.

Nor does such an interpretation of price redeterminable contracts destroy their virtue as an alternative method of contracting to contracts expressly providing for the reimbursement of costs plus a fixed fee. On the one hand they allow greater flexibility in resolving the inevitable disputes concerning the proper determination and allocation of costs. On the other hand—and this would seem to be their primary purpose—they do not fix the contractor's profit in advance but rather allow his efficiency and ingenuity in performance to be taken into account in negotiating the profit, thus preserving the contractor's incentive to minimize costs.

That retroactive negotiation of prices tends inevitably towards the allowance of costs plus a profit has been expressly recognized by the Comptroller General, who has cautioned against its administration in a way (that is, with an uncritical allowance of a standard percentage of profit) which would violate the statutory prohibition against the cost-plus-percentage-of-cost method of contracting. 33 Comp. Gen. 533; 33 Comp. Gen. 291.

The nature of this method of contracting is revealed even more clearly by the consequences of a failure by the parties to agree on a redetermined price. In that event, the contract provides that the contracting officer shall unilaterally determine the price subject to an appeal by the contractor to the

Armed Services Board of Contract Appeals. See ¶ (c) of the Price Revision clause (R. 33) and the Disputes clause (R. 25). The Board, in turn, consistently decides such appeals simply by determining whether disputed items of cost are "allowable" and adding to the costs thus determined what it considers to be a "fair" profit. See, *e. g.*, *Russell B. Gannon Co.*, ASBCA Nos. 1199 and 1388 (Dec. 14, 1953); *General Box Co.*, ASBCA No. 1737 (Aug. 18, 1954); *Polytechnic Research & Devel. Co.*, ASBCA No. 1995 (Oct. 13, 1954); cf. *Arco Mfg. Co.*, ASBCA No. 1117 (Feb. 10, 1954).[6] Since the decisions of the Board are subject to only a very limited review in the courts (see *United States* v. *Wunderlich*, 342 U. S. 98; 68 Stat. 81, 41 U. S. C. (Supp. V) 321), its decisions, for all practical purposes, establish the "law" governing such provisions.

Thus the contractor does, as a practical matter, have a "right" to be reimbursed for his actual costs. If the contracting officer will not agree to a price allowing such costs, the contractor may obtain relief by an appeal to the Armed Services Board of Contract Appeals. It follows that any increase of subcontracting costs caused by hidden kickbacks would be passed on to the Government. For this reason it seems clear that contracts providing for retroactive price redetermination, whatever their characterization for other purposes should be classified as "cost reimbursable" contracts for purposes of the Anti-Kickback Act.

[6] See also Board member Green's statement of the standards applied in such cases, *Costing and Pricing in Contract Appeals Procedures*, 18 Fed. B. J. 183, 189-196 (1958).

2. Petitioners base their argument almost exclusively upon the labels on the contract and the nomenclature used by the military departments to describe such contracts. Admittedly such contracts are generally referred to as "fixed-price contracts subject to price redetermination." That, literally, is what they are, for in the original negotiations of the contract a "fixed price" is indeed arrived at as a target. Nor is the target meaningless, for, supported as it is by detailed cost estimates, it indicates what the parties considered to be a reasonable profit on their admittedly uncertain assumptions as to the likely costs. Both the original cost estimates and the original profit margin provide a guide in the subsequent negotiations in determining how efficient the contractor has been and what a reasonable profit is. The important question, however—to which petitioners hardly address themselves—is not whether the words "fixed price" appear in the description of such contracts but whether making them "subject to price redetermination" so affects their nature as to bring them within the scope of the Anti-Kickback Act.

So also is it irrelevant whether such contracts are deemed to be within the purpose and scope of other regulatory or statutory provisions applicable to "cost" contracts. "Cost contracts" is not a descriptive phrase of immutable content; its meaning must depend in each case upon the background of the provision and the purpose sought to be served by it.

3. Petitioners contend that knowledge that the prime contract is a "cost reimbursable" contract is an essential element of the crime charged and that the

indictments are defective in failing to allege such knowledge. There is no basis for the contention, and the only other case on the question is fully in accord with the decision below. *Hanis* v. *United States*, 246 F. 2d 781 (C. A. 8).

Section 4 of the Act, the criminal provision, requires only that the "person * * * shall knowingly, directly or indirectly, make or receive any such prohibited payment." Under § 1, the civil provision providing for recovery of the payment, the payment is "prohibited" if it is *intended* as an "inducement" for a subcontract and if *in fact* the prime contract is a Government cost contract. Clearly, therefore, the only criminal intent required is the intent to bribe. The defendant need not know that the bribe was made under such circumstances as to be a federal crime—any more than a bank robber need know that the bank is a national bank (*Reynolds* v. *United States*, 67 F. 2d 216 (C. A. 9)) or a thief, that the goods were in interstate commerce (*Clark* v. *United States*, 213 F. 2d 63 (C. A. 5)). As in those cases, Congress here simply limited the scope of the Act to circumstances in which the United States has a sufficiently direct interest to make the exercise of federal jurisdiction appropriate. While the existence of those circumstances is essential to jurisdiction, knowledge of them is no more an element of the crime than is knowledge of the terms of the statute.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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